

William Grant Callow
March 31, 2006

A98-009 CIV (HRH)

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA AT ANCHORAGE

UNITED STATES OF AMERICA for the)
use of NORTH STAR TERMINAL &)
STEVEDORE COMPANY, d/b/a NORTHERN)
STEVEDORING & HANDLING, and NORTH)
STAR TERMINAL & STEVEDORE COMPANY,)
d/b/a NORTHERN STEVEDORING &)
HANDLING, on its own behalf,)
Plaintiffs,)

and)

UNITED STATES OF AMERICA for the)
use of SHORESIDE PETROLEUM, INC.,)
d/b/a MARATHON FUEL SERVICE,)
and SHORESIDE PETROLEUM, INC.,)
d/b/a MARATHON FUEL SERVICE,)
on its own behalf,)

Intervening Plaintiffs,)

and)

METCO, INC.,)

Intervening Plaintiff,)

vs.)

NUGGET CONSTRUCTION, INC.; SPENCER)
ROCK PRODUCTS, INC.; UNITED STATES)
FIDELITY AND GUARANTY COMPANY; and)
ROBERT LAPORE,)
Defendants.)

Case No. A98-009 CIV (HRH)

DEPOSITION OF WILLIAM GRANT CALLOW

Pages 1 - 90, inclusive

Friday, March 31, 2006, 9:17 a.m.

Taken on behalf of the Defendants
at

Barokas Martin & Tomlinson
1029 West 3rd Avenue, Suite 280
Anchorage, Alaska

COPY

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<p>1 ANCHORAGE, ALASKA; FRIDAY, MARCH 31, 2006 2 9:17 A.M. 3 -oOo- 4 (Exhibit 1 marked.) 5 WILLIAM GRANT CALLOW, 6 called as a witness herein, having 7 been first duly sworn upon oath, was 8 examined and testified as follows: 9 EXAMINATION 10 BY MR. VIERGUTZ: 11 Q. Good morning, Mr. Callow. 12 A. Good morning, Mr. Viergutz. 13 Q. You know the process: I ask questions; you 14 answer them. If you answer them, I have to assume 15 you understood the question. Is that acceptable? 16 A. Yes, sir. 17 Q. And if you don't understand it, you'll ask 18 me to rephrase it; will you do that? 19 A. Yes, I will. 20 Q. Your report is placed before you, 21 Exhibit 1, and I'd ask you to look at -- and that is 22 your report, you authored it, correct? 23 A. Yes. I want to take a look to see that all 24 the pages are here. 25 (Reviews document.)</p>	<p>1 A. Correct. 2 Q. And the documents that you reviewed to 3 author this report are referenced in the last two 4 pages attached to your report; is that correct? 5 A. That's correct. 6 Q. What is the volume of material, estimate, 7 that -- is it two inches, three inches, 20 inches? 8 A. I would estimate it's between three and 9 four inches. 10 Q. Three and four inches. 11 A. Yeah. 12 Q. Okay. 13 A. I want to make clear that we're talking 14 about the documents involved in this case, as 15 opposed to, you know, any cases that I reviewed or 16 something like that, but, yeah. That wouldn't have 17 been a thick -- real thick anyway, but, yes, that's 18 correct. 19 Q. Have you ever represented a surety? 20 A. No. 21 Q. If we'd go to page 3 of your report. Did 22 you review those letters referenced in the quote 23 under the "subject" heading, and then the next 24 paragraph it says, "We acknowledge receipt of serial 25 letter 611-19, dated August 6, '97 and serial letter</p>
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<p>1 Yes, that's correct. 2 Q. Okay. The first paragraph, the last two 3 sentences, it says, "I have been requested to opine 4 as to the treatment of claims by USF&G. I reviewed 5 documents provide to me by the attorneys for the 6 claimants and discussed this case with them." 7 Who did you discuss the case with, 8 Mr. Sewright? 9 A. Yes, sir. 10 Q. And what did you -- 11 A. And Mr. Shamburek. 12 Q. And did you talk to Mr. Sewright outside 13 the presence of Mr. Shamburek? 14 A. I don't recall. I may have. I can't 15 remember. I may have, but I think most often I -- I 16 talked to Mr. Shamburek outside the presence of 17 Mr. Sewright, but I don't know that I spoke to 18 Mr. Sewright outside the presence of 19 Mr. Shamburek. 20 Q. So you don't know? 21 A. Yeah, I can't remember. I don't -- it's -- 22 I'm just saying it's possible, but I don't have a 23 recollection if I spoke to him. 24 Q. Okay. You never saw any deposition 25 transcripts of any USF&G employees, correct?</p>	<p>1 611-21, dated August 11, '97? 2 A. I'm not sure, as I sit here today. I think 3 that I did. Let's see if these are -- if those are 4 referenced in the last -- in that last page. 5 (Reviews document.) 6 I can't be sure. I suspect that I did. 7 (Exhibit 2 marked.) 8 MR. SHAMBUREK: Now, Herb, I'd just like to 9 note that in an e-mail exchange I had asked you to 10 mark any exhibits that you were going to use for the 11 deposition, and you said there would be no 12 exhibits. 13 MR. VIERGUTZ: Outside what his report is. 14 And this is I believe what you saw as termed on the 15 second to the last page "Documents produced by USF&G 16 and marked 'USF&G' with some blank documents." 17 BY MR. VIERGUTZ: 18 Q. Does this look like what you reviewed? 19 A. What's just been marked as Exhibit 2? 20 Q. Correct. 21 A. Well, I have more documents than this that 22 I reviewed, so it's -- this is only about an inch 23 thick or so. And, yeah, some of these look 24 familiar. 25 MR. SHAMBUREK: Herb, I'll also observe,</p>

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<p style="text-align: right;">Page 8</p> <p>1 for the record, that I sent you an e-mail note and 2 said we'd make the documents that he reviewed 3 available for your inspection or copying. 4 MR. VIERGUTZ: Uh-huh. Uh-huh. 5 BY MR. VIERGUTZ: 6 Q. Why is the content of those two letters, do 7 you know, not cited in your report? 8 MR. SEWRIGHT: Object to the form of the 9 question. I -- 10 MR. VIERGUTZ: Hold it. Hold it right now. 11 Object to the form of the question, period. 12 Anything further than that I'm not going to put up 13 with. That's the only proper objection, and I think 14 Mr. Shamburek is the attorney representing 15 Mr. Callow; is that correct? 16 MR. SHAMBUREK: Mr. Callow is the expert 17 for all of the claimants, so I have been the one 18 who's talked most with him, but Mr. Sewright 19 represents North Star Stevedoring. 20 MR. VIERGUTZ: Okay. 21 MR. SEWRIGHT: I just didn't understand 22 what letters you're referring to. 23 BY MR. VIERGUTZ: 24 Q. Can you answer my question? 25 A. I understand that you're referring to</p>	<p style="text-align: right;">Page 10</p> <p>1 position taken by an owner. 2 A. I don't -- if we're talking about the 3 general contractor, there is an implied duty of good 4 faith and fair dealing in every contract. And if 5 that dispute is based on -- has a good faith basis, 6 then a legitimate dispute is not in and of itself 7 evidence -- or is not in of itself bad faith, that's 8 correct. 9 Q. Would you define bad faith for me, please. 10 A. Well, bad -- there are a couple of 11 different standards for bad faith. But bad faith is 12 the breach of the duty of good faith and fair 13 dealing that is implied in every contract, including 14 every insurance contract. And, according to Alaska 15 case law, every surety contract. 16 Q. I understand that. But bad faith means 17 what? 18 A. Well, it means lots of different things 19 depending on the context of the case. But basically 20 what it means is that a party takes a position that 21 is unreasonable or engages in conduct that is 22 unreasonable. Or -- or in reckless disregard for 23 rights, that can be -- there are numbers 24 of different -- there are different types of bad 25 faith. And I'm speaking now about Alaska law.</p>
<p style="text-align: right;">Page 9</p> <p>1 serial letter 611-19 and serial letter 611-21, 2 correct? 3 Q. Right. 4 A. If you could point those out to me, refresh 5 my recollection. 6 Q. No. My question to you is -- 7 A. Oh. 8 Q. -- do you recall why those letters are not 9 referenced in your report? 10 A. Well, in fact they are at page 3, and 11 that's the reference I made to them. But I didn't 12 believe that any further reference to them was 13 relevant to the opinions that I was asked to give 14 about USF&G's duties in this case. 15 Q. Okay. In your history, do you find it 16 unusual for a general contractor to dispute a 17 position taken by an owner? 18 A. Certainly it happens. Is it unusual? I 19 wouldn't say it's unusual, no, I wouldn't say that 20 it's like a strange occurrence, if that's what you 21 mean. 22 Q. Is that bad faith? 23 A. Would you explain to me what you mean by is 24 it bad faith, to dispute? 25 Q. For a general contractor to dispute a</p>	<p style="text-align: right;">Page 11</p> <p>1 Q. And who determines whether the position is 2 unreasonable? 3 A. Well, I guess the question becomes at what 4 point. But usually that is determined in a court of 5 law, sometimes by a jury, or sometimes by a judge. 6 Q. And if the allegation has no merit, it 7 could potentially never make it to a judge or a 8 jury; is that correct? 9 A. If the -- I want to make sure that we're on 10 the same page. If the allegation of bad faith has 11 no merit, yes, that's true -- well, I guess it could 12 make it to a judge but it could be dismissed on 13 summary judgment, that's correct. 14 Q. If you'd go to the bottom of page 3, the 15 final sentence. It says: The letter states that it 16 was courtesy copied to United States Fidelity & 17 Guarantee Company, Attention Bill Wells, 4220 B 18 Street, Anchorage, Alaska 99503. 19 A. Yes, sir. 20 Q. Do you know whether Mr. Wells works at that 21 location? 22 A. I do not have any independent knowledge of 23 that. 24 Q. Okay. Are you familiar with Willis of 25 Alaska?</p>

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<p style="text-align: right;">Page 12</p> <p>1 A. Yes, uh-huh. 2 Q. And what do they do? 3 A. They're insurance brokers. They procure 4 insurance for clients. 5 Q. Or surety bonds? 6 A. Uh-huh, I believe so. 7 Q. Have you ever dealt with Bill Wells? 8 A. I have not. 9 Q. Do you know what the relationship is 10 between Willis and a surety? 11 A. I don't. I have no specific knowledge of 12 what the relationship was. I mean, you could make 13 some assumptions from these documents, but no, I 14 don't. 15 Q. Okay. If I represented to you that Bill 16 Wells was an underwriter, do you know what the 17 duties of an underwriter are? 18 A. Yes. 19 Q. And what are they? 20 A. The duties of an underwriter are to 21 assess a -- basically a risk and determine a 22 premium, essentially. 23 Q. Have you ever dealt with Jim Ferguson of 24 Willis? 25 A. No, sir.</p>	<p style="text-align: right;">Page 14</p> <p>1 BY MR. VIERGUTZ: 2 Q. Do you recall reviewing such a file? 3 A. No. I can't say that I ever -- I may have 4 seen documents that were in that file, but no, I 5 never saw anything that was called the surety 6 file. 7 Q. Okay. Do you know what the relationship of 8 Mr. Wells is when you, on page 4 under "Early 9 Correspondence" of your report, Exhibit 1, the first 10 two lines you mention Mr. Ferguson and Mr. Wells. 11 Do you know what the relationship is 12 between Mr. Ferguson and Mr. Wells? 13 A. Well, obviously they work together. When 14 you say "Do I know what their relationship is," my 15 understanding is that Mr. Ferguson works here in 16 Anchorage for the broker, and Mr. Wells works for 17 USF&G. 18 Other than that, I can't -- I don't 19 really -- when you say what their relationship is, I 20 think that they have probably a fairly close working 21 relationship to the extent that -- that Willis, 22 basically sells product of USF&G. 23 Q. Do you have enough knowledge to opine as 24 whether Mr. Ferguson would be an agent, in the legal 25 sense of the word, of USF&G?</p>
<p style="text-align: right;">Page 13</p> <p>1 Q. You've never met him? 2 A. No, sir. 3 Q. Did you discuss Mr. Ferguson's deposition 4 in this case with Mr. Shamburek or Mr. Sewright? 5 A. Not that I recall. The name Ferguson, of 6 course, certainly rings a bell, but the specifics of 7 the deposition I don't recall right now. 8 Q. Okay. And I don't believe that deposition 9 was transcribed, but if it was -- 10 A. Oh. 11 Q. -- I'm an idiot, because I don't have a 12 copy. But have you ever read -- 13 A. No, sir. 14 Q. -- such a transcript? 15 A. No, I have not. 16 Q. Did you review the surety file of Willis? 17 MR. SHAMBUREK: I'd just like to object to 18 the extent that I don't know if any of us are really 19 sure what the surety file of Willis is. If you 20 could just clarify which documents you're referring 21 to. 22 MR. VIERGUTZ: The surety file was 23 represented to be the surety file in Mr. Ferguson's 24 deposition, and we had the opportunity to have that 25 copied.</p>	<p style="text-align: right;">Page 15</p> <p>1 A. Well, that's -- that's an interesting legal 2 question. And I will tell you this: That in the 3 normal course of things, as a legal matter, there 4 are -- there may be certain circumstances where 5 the -- the insurance seller would be, what we'd 6 normally call an agent, in this case, Ferguson, 7 might be considered an agent in certain 8 circumstances. But normally that person is the 9 agent -- when you have an insurance agency that 10 provides a variety of product from a variety of 11 different sources, under those circumstances, the 12 agent is not considered to be a specific agent of 13 any one of the particular insurers but instead is 14 considered to be the agent of the person purchasing 15 the insurance. 16 There are some exceptions. For example, 17 dedicated -- what I refer to as a dedicated 18 insurance office, such as State Farm. A State Farm 19 agent only sells a State Farm product, and therefore 20 is considered to be a State Farm agent in the legal 21 sense of the word. Whereas if you have -- and same 22 with Allstate. 23 Whereas if you have -- I'm trying to think 24 of one of the other brokerage firms. I guess where 25 they might sell Horace Mann and they might sell</p>

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<p style="text-align: right;">Page 16</p> <p>1 other types of product, under those circumstances, 2 the majority of the case law, last time I reviewed 3 it, was that normally those agents are considered 4 the agents of the person purchasing the insurance. 5 They have their duty to them, but if that duty is 6 breached -- for example, if they don't -- if they 7 don't supply a good product, they can be made 8 liable. But you can't, for their negligence, 9 necessarily hold the insurer liable. There are some 10 exceptions, but that's the general rule. 11 Q. I appreciate that discussion. However, in 12 this case -- 13 A. Okay. 14 Q. -- do you intend to offer an opinion that 15 Willis was the agent of USF&G? 16 A. Do I intend to offer -- I haven't been 17 asked that specific question. So based on what I 18 know at this point, I can't answer that. But the 19 opinions that I expect to offer in this case, at 20 this time, are the ones that are set forth in my... 21 Q. In your report, Exhibit 1? 22 A. In my report, yeah. 23 Q. And that's not an opinion contained within 24 Exhibit 1, is it? 25 A. Well, I'm just -- you know, let me -- I</p>	<p style="text-align: right;">Page 18</p> <p>1 arisen in the context of personal injury, sometimes 2 the personal injury work spins off into insurance 3 bad faith. 4 I have, in recent years, been 5 undertaking -- I've been doing less of that and 6 doing a variety of other things. I mean, I did -- 7 I've done some discrimination claims, Title -- 1981 8 claims. 9 I have been doing -- I have been working 10 with some Scandinavian clients, assisting them in 11 providing -- in obtaining and monitoring the legal 12 work that's done for them in the United States. 13 I have been working on a number of class 14 action suits involving various things, ATM machines, 15 ATM fees. 16 And most recently, I've gotten involved in 17 a case involving a derivative shareholder suit in 18 California. It's a variety of things. 19 Q. What are the differences between -- 20 A. No divorces. 21 Q. -- between a surety and an insurer? 22 A. Well, a surety is actually providing 23 protection to -- it's a type of a third-party 24 contract. And the best definition of it and 25 distinction is in a case up here called the Loyal</p>
<p style="text-align: right;">Page 17</p> <p>1 want to make sure that -- I haven't reviewed this. 2 (Reviews document.) 3 I guess -- I guess my position is this, 4 that under certain circumstances if someone 5 voluntarily begins to act in a manner whereby they 6 assume duties, they can therefore become liable for 7 not doing those duties in a reasonable and proper 8 manner. 9 To the extent that Ferguson was involved in 10 this and obtained information that he knew or should 11 have known, should have been supplied to other 12 parties, you know, I think that there is -- there is 13 an argument to be made there that Ferguson could be 14 considered to be an agent of sort. 15 Q. Do you intend to offer an opinion that 16 Mr. Ferguson breached his duties? 17 A. At this point I tend to only offer the 18 opinions that I -- that I have set forth in here. 19 Q. And that's not an opinion contained in 20 Exhibit 1, is it? 21 A. No. 22 Q. What is the general area of your practice? 23 What is -- what law do you practice? 24 A. Well, I have been doing a fair amount of 25 insurance coverage work. And sometimes that has</p>	<p style="text-align: right;">Page 19</p> <p>1 Order of Moose, I don't know what the cite is, but 2 that will tell you specifically what it is. 3 But in the normal insurance circumstance, 4 an insurer provides protection to the insured 5 against third-party liability. A surety, on the 6 other hand, is really providing protection to a 7 third party. And that's the essential difference. 8 The person who's paying the premium is 9 paying a premium for the protection of third -- of 10 third parties. But the coverage that is being 11 provided is being specifically provided to the third 12 party, so it makes it different than what is called 13 a third-party insurance contract -- or I'm sorry. 14 What's called a third-party claim where, in the 15 average automobile case, someone -- I have insurance 16 on my car and for driving, I run a stop sign, I 17 injure somebody, they sue me, my insurance company 18 defends, that's a third-party claim. 19 Most courts hold that the insurer, even 20 though I bought insurance to maybe protect the 21 person that I might injure, that is -- the courts 22 say, no, you really bought insurance, in that 23 circumstance, to protect yourself. 24 In the case of a surety, there I'm 25 buying -- I'm paying a premium to protect a third</p>

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<p style="text-align: right;">Page 20</p> <p>1 party specifically from a particular contingency, 2 and in this case it's payment. 3 Q. What are the differences between the duties 4 of a surety and an insurer? 5 A. Well, I assume you're talking about -- in 6 terms of claims investigation and handling; is that 7 correct? 8 Q. You can answer that. 9 A. Okay. The essential difference -- well, in 10 fact, both have a duty of good faith and fair 11 dealing. Under Alaska law, I'm speaking of Alaska 12 law. Alaska law is applicable under the Miller Act, 13 and the duties of good faith and fair dealing in an 14 insurance context, whether for a bonding company or 15 for any liability company, are essentially identical 16 when it comes to duties to investigate claims. And 17 to investigate them thoroughly, to reasonably pay 18 claims, all the duties that are set forth or the 19 standards that are set forth in the Alaska Insurance 20 Code, Title 36, and in the appropriate 21 administrative regulations. 22 But in terms of their duty to investigate 23 claims and to pay claims, duties are similar. 24 Q. Does a surety have a duty to the 25 principal?</p>	<p style="text-align: right;">Page 22</p> <p>1 none, the principal wouldn't be harmed by the 2 negligence, there would be no interest that the 3 principal would have if the surety overpaid a claim 4 or paid an invalid claim. The surety would be just 5 out the money. 6 Where there is an indemnity agreement, that 7 indemnity agreement limits the right of the surety 8 to recover from the principal, to the extent that 9 the surety has been negligent and overpaid a claim 10 or paid an invalid claim. 11 So the surety still has the obligation to 12 carefully investigate and pay claims as required by 13 law, always has. And that obligation is to the -- 14 what I will refer to as the thirds, the third -- or 15 the insureds, the third-party beneficiaries. 16 Existence of the indemnity agreement merely 17 means that there is -- there is also, rather than a 18 duty, really -- I hate to rephrase it as a duty, but 19 it's -- it's a circumstance where the negligence of 20 the surety, as I've said before, in failing to 21 properly investigate a claim, paying any claim that 22 is invalid or overpaying a claim, limits the right 23 to indemnity. 24 Q. I don't see, in the last two pages attached 25 to your report, that you reviewed the general</p>
<p style="text-align: right;">Page 21</p> <p>1 A. Well, yes. Particularly where there 2 is a -- there is an indemnity agreement of some 3 sort. There is a duty to the principal, there is no 4 question about that. 5 But the -- there is -- there is a duty to 6 the insureds and -- let me -- let me step back. 7 You can't have a surety just recklessly 8 paying claims and then looking to its principal and 9 saying, now you got to pay us back. They have to 10 act reasonably. They have to reasonably investigate 11 the claim, do it reasonably promptly, and then -- 12 and then pay the claim. And at that point they can 13 turn to their principal. 14 But if it turns out that they did any of 15 that negligently and paid too much, they have -- to 16 that extent, forfeited their right to collect from 17 the principal. 18 Q. How is that duty impacted, if you know, by 19 the general agreement of indemnity? 20 A. How is -- say that again, please. 21 Q. How is the duty to the principal impacted, 22 if you know, by the general agreement of 23 indemnity? 24 A. Well, the general agreement in indemnity -- 25 maybe the best way to put it is this: If there were</p>	<p style="text-align: right;">Page 23</p> <p>1 agreement of indemnity in this case. Did you? 2 A. Well, I'd have to go back and look at my -- 3 I'd have to look at my notebook to see that, if I 4 did or not. I can't -- as I sit here today, I can't 5 remember if I did. I certainly understood that 6 there was one and I -- and I considered that to be 7 something important to know. 8 Q. The second to the last page of the 9 attachment to your report, it's a letter dated 10 February 8th, 2006, the final paragraph says, "All 11 of the pleadings, discovery, disclosures and 12 transcribed depositions are readily available for 13 your review. Please let me know what you would like 14 to review." 15 Did you advise Mr. Shamburek or 16 Mr. Sewright that you wanted to review any documents 17 that are not referenced above this paragraph? 18 A. That's a good question. I don't believe 19 so. I -- you know, I'm trying to think. I may 20 have, but specifically, I don't recall asking to see 21 that one. 22 Q. What is the duty of the surety to the 23 obligee? 24 A. Well, there are lots of duties, but if 25 we're talking about the -- in the claim context,</p>

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<p style="text-align: right;">Page 24</p> <p>1 there is the duty to promptly investigate a claim, 2 to reasonably investigate the claim. To pay the 3 claim, any claims that are valid, in a prompt 4 manner. There is a duty to communicate in a timely 5 fashion concerning the claims. And most of the 6 duties, or many of the duties, are embodied in 7 Title 36 of the Alaska Insurance Code and in the 8 corresponding administrative regulations. 9 Q. Do you know Mr. John George? 10 A. I've spoken to him on the phone. Many 11 years ago. 12 Q. Do you have -- based on your knowledge of 13 him, do you intend to offer an opinion that he's 14 either competent or incompetent, or don't you have 15 sufficient knowledge to render an opinion? 16 A. Well, I will say, this is what I know, I 17 don't -- I can't say, as I sit here, that the man is 18 incompetent, by any means. In fact, I contacted him 19 years ago about the possibility of having him serve 20 as an expert witness for me. I didn't hire him. I 21 won't tell you that it was because I thought he was 22 incompetent. 23 In my dealings with him, he was courteous 24 and professional. I know that he has experience in 25 the field. I don't know a great deal about his</p>	<p style="text-align: right;">Page 26</p> <p>1 Q. And was that covered in your continuing 2 education course? 3 A. No, sir. 4 Q. In your practice do you find it unusual for 5 an attorney and a client to take positions 6 contradicting or confrontational to other attorneys 7 and their clients? 8 A. I don't find that -- I don't find that 9 unusual. 10 Q. Page 5 of your report, around the middle of 11 the page. There's a sentence that reads, and my 12 question is going to be... 13 The darkened part. "At this time, I would 14 appreciate it if you could provide me with any 15 information regarding whether this is an ongoing 16 account, because based on the information available 17 to me at this time some of the defenses of the 18 principal may be questionable." Why is that 19 darkened? 20 A. My recollection, as I sit here, without 21 looking at the original document, is that it was -- 22 it was originally darkened in the first place. 23 Q. Okay. 24 A. I mean, I put in "emphasis added" and I 25 can't remember -- it may be that I added the</p>
<p style="text-align: right;">Page 25</p> <p>1 background in the industry. I know that he served 2 as the director of the Division of Insurance for a 3 while and that's why I contacted him. 4 (Phone rings, off record.) 5 BY MR. VIERGUTZ: 6 Q. Page 12 of your report, which is the final 7 page prior to your signature there. 8 A. Uh-huh. 9 Q. It says, "Other Testimony," and in the 10 final sentence of that paragraph it says: I have 11 also taught a continuing legal education course on 12 the subject of discovering and proving insurance bad 13 faith. 14 A. Yes. 15 Q. Have you ever taught a continuing legal 16 education course on the subject of discovering and 17 proving surety bad faith? 18 A. Well, to the extent that I consider 19 sureties and did consider -- have considered 20 sureties to be insurers, the answer is yes. But 21 specifically, in that particular course, I never 22 discussed sureties. 23 Q. Are you aware that there is a body of law 24 called suretyship law? 25 A. Yes.</p>	<p style="text-align: right;">Page 27</p> <p>1 emphasis, but I can't recall. 2 But, you know, clearly that -- that was 3 important, that is important to me, because this was 4 the first time, and this was early on, that we know 5 that Ms. Poling understood that there were -- that 6 the defenses were -- of the principal were 7 questionable, or may be questionable. 8 Q. She's not saying they were questionable, is 9 she? 10 A. No. No. "May be." 11 Q. And you never spoke to Ms. Poling? 12 A. No, sir. 13 Q. Regarding her intent? 14 A. No. 15 Q. The next line, that's no longer a part of 16 Ms. Poling's letter, correct, where you're saying 17 "USF&G acknowledged the questionable defenses of 18 Nugget at least by October '97"? 19 A. Yes. 20 Q. And where did they acknowledge it? 21 A. Oh. If you look up at what I was referring 22 to here, as I recall, is that by Ms. Poling's e-mail 23 to Bill Wells of 10/24, and that actually -- since 24 it's an e-mail, I don't -- I don't believe now that 25 that was originally highlighted, so I guess I</p>

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<p style="text-align: right;">Page 28</p> <p>1 highlighted, that's why emphasis is added. 2 But we know from her e-mail that US -- when 3 I say acknowledged, USF&G, by October 24, the date 4 of that e-mail, was aware of -- that Nugget had 5 questionable defenses. That's what I meant. 6 Q. That they had them or may have had them? 7 A. Well, they may have them. At least that 8 they were on notice -- they appeared to be on notice 9 that there needed to be an investigation, at least, 10 that's what -- that's what that tells me. 11 Q. Do you recall reviewing anywhere where 12 USF&G was saying that they agreed that the defenses 13 of Nugget were questionable? 14 A. I want to make sure that I answer that 15 question carefully, because to my -- the way I 16 interpreted this e-mail is that they were aware that 17 there were issues concerning whether defenses were 18 viable, that there were questionable defenses. And 19 that therefore, at that point, I would say yes, they 20 were aware that there were issues concerning 21 viability or the legitimacy of the defenses, of some 22 of the defenses. 23 So did they say that they were 24 questionable? It says -- here it says they may be 25 questionable. I don't know how to say that other</p>	<p style="text-align: right;">Page 30</p> <p>1 using those words, correct, I did not see that. 2 Q. Okay. As an attorney, does a decision of 3 the Ninth Circuit trump a decision of a federal 4 court judge? 5 A. If you're talking about a federal district 6 court judge? 7 Q. Yes. 8 A. And one who is in the Ninth Circuit? 9 Q. Yes. 10 A. The answer is that the Ninth Circuit would 11 control over anything that might be inconsistent 12 with the lower court, would be, as you say, trumped 13 by the Ninth Circuit, yes. 14 Q. Now, again on page 5, in the final 15 paragraph, it's a quote from the Ninth Circuit. It 16 says, "On the record before us, the appellees have 17 presented sufficient evidence to create a material 18 issue of fact as to subterfuge or collusion." 19 Do you read that to say that there was 20 subterfuge or collusion? 21 A. No, sir. 22 Q. It was just an issue of fact; is that 23 correct? 24 A. Correct. 25 And I would add, a material issue of fact.</p>
<p style="text-align: right;">Page 29</p> <p>1 than -- I don't think anybody would have written 2 that if they didn't believe that there were -- there 3 were things that needed to be discovered or to be 4 investigated to determine if they were valid 5 defenses. 6 So I don't know whether I've answered your 7 question, but I think that's -- I have to be very 8 careful here because I think -- you know, somebody 9 writes this and they say, well, the defenses of the 10 principal may be questionable. 11 In this context, I believe a reasonable 12 interpretation is that this woman wrote this because 13 she believed that those questions may be really 14 meant, are questionable, or that there is -- there 15 are -- there is evidence that we're aware of that 16 makes us believe that they're not legitimate. Is 17 that clear? 18 Q. It's clear. It did not answer my question. 19 A. Okay. 20 Q. My question is, do you recall ever reading 21 specifically where USF&G says: Nugget is forwarding 22 questionable defenses? Not that they may be 23 questionable, that they are questionable. 24 A. The answer is, that that's how I would 25 interpret this e-mail, as saying that, but I --</p>	<p style="text-align: right;">Page 31</p> <p>1 Q. Now, if we could go to page 6, the first 2 paragraph above "Proofs of Claim," the final 3 sentence. It says, USF&G knew or should have known 4 that Nugget was attempting to prevent this evidence 5 from being disclosed as early as September or 6 October '97, and should have undertaken greater 7 scrutiny of Nugget's representations to it. 8 Now, if we could break that sentence down, 9 please. First of all, do you know what USF&G knew 10 or didn't know on that date? 11 A. I certainly know some of what they knew. I 12 knew that they were -- yes, to answer your question, 13 yes. 14 Q. And what did they know? 15 A. Well, they knew enough to know that, as we 16 referred earlier, that Nugget's -- there were 17 questionable defenses by Nugget, and that -- that 18 Nugget had -- they had sufficient knowledge to know 19 that Nugget was attempting to prevent the evidence 20 from being disclosed. 21 Q. Do you know what reasons Nugget had for its 22 actions or inactions? 23 A. Well, the simple answer is that I believe 24 that what Nugget was trying to do was to maximize 25 its income from the project at the expense of the</p>

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<p>1 subs.</p> <p>2 Q. And how do you come to that conclusion?</p> <p>3 A. Well, because Nugget was seeking payment on</p> <p>4 this job and was not paying the subcontractors.</p> <p>5 Q. And for your answer are you assuming that</p> <p>6 Shoreside or North Star were subcontractors to</p> <p>7 Metco?</p> <p>8 A. Well, yes.</p> <p>9 Q. Now, the final -- after your 1997 in that</p> <p>10 sentence, it says: "And should have undertaken</p> <p>11 greater scrutiny of Nugget's representations to it."</p> <p>12 What does that mean?</p> <p>13 A. Well, let me see if I can refer you to</p> <p>14 another section where I explain this. If you look</p> <p>15 at page 11 of my report in the third paragraph down,</p> <p>16 I -- that summarizes. But at the end of that</p> <p>17 paragraph: Figuratively speaking, USF&G allowed the</p> <p>18 fox into the hen house and then abandoned the three</p> <p>19 hens it had a duty to reasonably protect.</p> <p>20 USF&G's primary duty was to protect the</p> <p>21 obligees. And to that extent, had a duty to</p> <p>22 carefully, reasonably, and in good faith scrutinize</p> <p>23 the information that was provided to it or that it</p> <p>24 became aware of concerning Nugget's representations.</p> <p>25 It can't just simply say "I'm going to --</p>	<p>1 other people were present, I will talk to the other</p> <p>2 people that were present, or I will have an</p> <p>3 investigator do that.</p> <p>4 If the client tells me -- I'm just trying</p> <p>5 to think of some good examples. I almost -- I mean,</p> <p>6 I can't even think of when I haven't investigated to</p> <p>7 make sure that what the client tells me is correct.</p> <p>8 Because it's my professional reputation</p> <p>9 that's on the line, and the last thing I want to do</p> <p>10 is get involved in a court case and have something</p> <p>11 come out of left field that not only guts the case,</p> <p>12 but really professionally embarrasses me, so I feel</p> <p>13 like, yes, I've got a duty to look at that. I don't</p> <p>14 take what clients tell me at face value.</p> <p>15 Q. Hypothetically, you're USF&G, what would</p> <p>16 you have done in this case?</p> <p>17 A. I would have undertaken an independent</p> <p>18 investigation of the facts. I would have</p> <p>19 interviewed the individuals involved. I would have</p> <p>20 determined what work had been done, and the quality</p> <p>21 of that work.</p> <p>22 I would have asked Nugget to explain in</p> <p>23 detail and in writing the reasons why it had not</p> <p>24 been paying these contractors, subcontractors. I</p> <p>25 would have -- having tendered the defense to Nugget,</p>
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<p>1 USF&G can't just say, well, whatever Nugget tells us</p> <p>2 we're just going to believe, particularly where, as</p> <p>3 here, they have reason to believe that there needs</p> <p>4 to be an independent investigation of some of --</p> <p>5 where things aren't making sense.</p> <p>6 In any case, the surety has an obligation</p> <p>7 to investigate in good faith on the claims. And to</p> <p>8 pay them if they're valid. So that's what I --</p> <p>9 that's what I intended to convey here.</p> <p>10 Q. When you have a client and a client tells</p> <p>11 you something, do you investigate what that client's</p> <p>12 telling you?</p> <p>13 A. Yes. I usually -- I mean, I have -- I</p> <p>14 usually make it clear, and I believe I have a</p> <p>15 standard clause in my contract, that if it</p> <p>16 becomes -- that if I learn that the client has</p> <p>17 failed to disclose material facts or has</p> <p>18 misrepresented material facts, that I have a right</p> <p>19 to withdraw. I think that's how -- it's worded</p> <p>20 something like that.</p> <p>21 Q. How do you go about investigating what the</p> <p>22 client tells you?</p> <p>23 A. Well, that's a good question. I usually --</p> <p>24 it depends on what kind of case it is. But if the</p> <p>25 client tells me about certain events occurring where</p>	<p>1 I would have monitored Nugget's defense extremely</p> <p>2 carefully.</p> <p>3 For example, one of the things that</p> <p>4 happened in here, that I think was very bizarre and</p> <p>5 really inexcusable, was some defense that was made</p> <p>6 saying that this wasn't a federal project, this was</p> <p>7 not a -- yeah, it wasn't a federal project. And I</p> <p>8 think that's the kind of thing that -- I mean,</p> <p>9 it's -- according to my interpretation of the</p> <p>10 standards in Title 36, that's -- that's the kind of</p> <p>11 litigation tactic that is completely unacceptable,</p> <p>12 and I think USF&G had to determine that Nugget was</p> <p>13 defending this, there's a good faith standard.</p> <p>14 USF&G can't get around good faith standards by</p> <p>15 saying, well, we're just going to tender to Nugget</p> <p>16 and wash our hands of this.</p> <p>17 I'll give you -- I'll give you another</p> <p>18 example. In the circumstance of an insurance --</p> <p>19 underinsured motorist claim, that's a first-party</p> <p>20 claim that's similar, where a person who has been</p> <p>21 hit by an uninsured motorist has to file a claim</p> <p>22 against their own insurer.</p> <p>23 And there is an adversarial position there,</p> <p>24 but the insurer in that circumstance has duties to</p> <p>25 its insured, good faith duties to its insured, even</p>

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<p style="text-align: right;">Page 36</p> <p>1 in the context of that adversarial relationship, to 2 investigate carefully the claim and pay the claim. 3 That was the Weiford case up here. And in the 4 surety circumstance, the surety has that similar 5 type of obligation to the obligees. 6 Q. You pointed out the, what you called, 7 bizarre defense. Why wasn't Nugget able to make 8 that defense? Again, hypothetically, you're USF&G. 9 If they want to make a defense, aren't they entitled 10 to assert it? 11 A. Well, remember, USF&G has tendered the 12 defense, but in so doing it has -- and it actually, 13 in this case, undertook or assumed the obligation of 14 monitoring how that defense was being provided 15 and -- or how the defense was being conducted. 16 And if you ask me do they have a right to 17 assert any defenses that they want, the answer is 18 that Nugget can do whatever it wants, USF&G, 19 however, has to make sure that Nugget is not just 20 vexatiously litigating the case, trying to drive the 21 claimants away from the claim by running up costs. 22 I mean, that's an insurance bad faith practice right 23 there. 24 Q. You're USF&G in this case. And you're 25 sitting there seeing this defense being made.</p>	<p style="text-align: right;">Page 38</p> <p>1 MR. VIERGUTZ: The objection has been made 2 as to form, I believe. 3 MR. SEWRIGHT: Yeah. And I object also as 4 to form on other grounds. 5 BY MR. VIERGUTZ: 6 Q. Would you please answer the question. 7 A. Could you repeat the question again. 8 MR. VIERGUTZ: Would you read the question 9 to the witness. 10 (Question read back.) 11 THE WITNESS: No, I disagree with that. 12 BY MR. VIERGUTZ: 13 Q. The next paragraph on page 6 under Proofs 14 Of Claim, the second sentence says, "Ms. Poling sent 15 a letter dated January 14th, '98 to Robert LaPore, 16 president of Spencer Rock Products, Inc. 17 acknowledging that Spencer provided a proof of claim 18 and supporting documents but denying the claim." 19 Do you recall that letter also asking for 20 additional documents? 21 A. I don't have an independent recollection of 22 that. I'd have to review it. 23 Q. Okay. We will. 24 A. Okay. 25 Q. The next paragraph, the final sentence</p>
<p style="text-align: right;">Page 37</p> <p>1 Okay? 2 A. Uh-huh. 3 Q. Just hypothetically again. Don't you have 4 an obligation to allow the principal to assert a 5 defense if the principal believes it has merit? 6 A. Well, the answer is, you can't defer -- if 7 you're USF&G, you can't simply defer to Nugget, 8 because you have an obligation to the obligees. So 9 if in fact there are legitimate defenses to the 10 obligee's claim, those can be -- those can be 11 presented and conducted. 12 If, on the other hand, there are not 13 legitimate defenses to the obligee's claim, then -- 14 or if some of the defenses that are raised are not 15 legitimate themselves, then USF&G has a duty to stop 16 that. That's why they're -- that's why they're 17 monitoring. They're in a position where they 18 have -- their principal duty, as I see it, is to the 19 obligees, the insured. 20 Q. Isn't it a fact that the only duty to the 21 obligee is to pay a claim of the principal if the 22 principal doesn't pay that claim? 23 MR. SHAMBUREK: I've got to object. Asked 24 and answered. About five minutes ago you asked for 25 the duties and he set them forth.</p>	<p style="text-align: right;">Page 39</p> <p>1 says, "USF&G does not appear to have undertaken any 2 more investigation of the claim or to have sought 3 any additional information from Shoreside." 4 What is that statement based on? 5 A. That is based on the fact that, from what I 6 know, USF&G did not -- I have no -- I have no 7 information that's provided to me that USF&G 8 undertook any more investigation of the claim. That 9 was my conclusion, that there was no follow up. 10 Q. After December 16, '97? 11 A. Let me make sure here. 12 (Reviews document.) 13 Yes, that's -- after -- well, after 14 January 5, '98, I guess you would say. Because 15 really Poling is asking Nugget to provide more 16 information, so... 17 Q. Okay. And if you'd look at Exhibit 2 in 18 front of you, page 40. There's numbered pages in 19 the bottom left. 40. 20 A. Yes, I've got it. Uh-huh. 21 Q. That's the December 16th letter you're 22 referring to; is that correct? 23 A. Yes, I believe that's correct, uh-huh. 24 MR. SHAMBUREK: Herb, I just note, this 25 number says 40 and it doesn't have the USF&G numbers</p>

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<p style="text-align: right;">Page 40</p> <p>1 that were on the documents that were provided by 2 USF&G. 3 BY MR. VIERGUTZ: 4 Q. Okay. And then No. 44 on the bottom left. 5 A. Yes, I'm here. 6 Q. Do you see that letter? 7 A. Yes, the 17th. 8 Q. That's December 17th? 9 A. Correct. 10 Q. You've seen that letter before today? 11 A. Yeah, I believe so. 12 Q. And there Nugget's attorneys are responding 13 to USF&G; is that correct? 14 A. That's correct. 15 Q. And then if you turn to the same exhibit, 16 No. 2, page 52. 17 A. Yes. 18 Q. That's February 17, '98, and that's Poling 19 receiving a letter again from Oles Morrison, Nugget 20 attorneys? 21 A. That's correct. Dealing with the Chugach 22 rock claim, yes. 23 Q. And then if we could go to page 74. 24 A. Yes, I'm there. 25 Q. This is a September 1 letter from Oles</p>	<p style="text-align: right;">Page 42</p> <p>1 that issue. Be that as it may, it's neither your 2 nor my deposition. 3 BY MR. VIERGUTZ: 4 Q. Now, if we could go back to 055. That's a 5 March 3rd, '98 letter. 6 A. Yes. 7 Q. That's after January 5th, '98, referenced 8 in Exhibit 1, your report, at paragraph 3 that we're 9 talking about, correct? 10 A. Yes. 11 Q. And this is a letter that's -- goes to 12 page 66, is that correct, that would be 11 pages 13 long? 14 MR. SHAMBUREK: Herb, I'm just going to 15 object to the extent that this letter was not in the 16 documents that were provided by USF&G to us, and it 17 thus cannot be in the materials conveyed to 18 Mr. Callow, because he did not receive anything 19 beyond what you provided to us. 20 MR. VIERGUTZ: Then it was by your omission 21 and not mine, because I provided it to you with a 22 cover letter a couple days after realizing that 23 omission from these documents. 24 MR. SHAMBUREK: I don't recall the cover 25 letter or the document. Do you have a copy of it?</p>
<p style="text-align: right;">Page 41</p> <p>1 Morrison to USF&G thanking them for talking to them 2 about the subpoena for the records deposition and 3 asking that USF&G forward their records to them; 4 correct? 5 A. May I just take a moment here and just 6 review this? 7 Q. Sure. 8 A. (Reviews document.) 9 Yes, that's correct. 10 Q. Where did you come to the understanding 11 that USF&G did not receive the briefs for the Ninth 12 Circuit and the pleadings and summary judgment and 13 such? 14 A. Because nothing that I reviewed indicated 15 to me that they got that information. 16 Q. And so you never saw a couple boxes of 17 documents forwarded by USF&G which contained those 18 materials; is that correct? 19 A. That's correct. 20 MR. SHAMBUREK: Herb, there's still an 21 objection to foundation, to the extent you say there 22 were boxes, because I don't think there were any 23 boxes of information provided by USF&G during the 24 document review in November and December. 25 MR. VIERGUTZ: You and I stand at odds on</p>	<p style="text-align: right;">Page 43</p> <p>1 MR. VIERGUTZ: No. 2 MR. SEWRIGHT: Herb, have you totally 3 reordered these by date from what you produced? 4 MR. VIERGUTZ: I'm not being deposed and 5 I'm not -- 6 MR. SHAMBUREK: Herb, I'm going to 7 object. 8 MR. VIERGUTZ: -- prepared to answer 9 questions. 10 MR. SEWRIGHT: Yeah, but -- yeah, but -- 11 MR. SHAMBUREK: These are not the documents 12 that were provided by you in this order that were 13 then provided to Mr. Callow. I sent an e-mail and I 14 said if you wanted to review those documents I would 15 provide them. These are more, they're different, 16 and they're marked with other numbers. So we're 17 going to object to any of these questions. 18 BY MR. VIERGUTZ: 19 Q. Now, page 55. 20 A. Yes. 21 Q. You've never seen that letter before? 22 A. I don't recall seeing this letter, that's 23 correct. 24 Q. Would you say that that is an additional 25 document?</p>

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<p style="text-align: right;">Page 44</p> <p>1 A. Dealing with Shoreside?</p> <p>2 Q. Explaining the position of Nugget to USF&G.</p> <p>3 A. Well, let me say this. It depends on how</p> <p>4 much time you want me -- I haven't -- I'd like to</p> <p>5 review it, but would you like me to just review it</p> <p>6 briefly and say --</p> <p>7 Q. Whatever you need to answer that question.</p> <p>8 A. All right. Let me just take a moment here.</p> <p>9 (Reviews document.)</p> <p>10 MR. SHAMBUREK: While we're still on</p> <p>11 record, Herb, do you have a copy of the transmittal</p> <p>12 letter of this document?</p> <p>13 Do you recall seeing a transmittal letter,</p> <p>14 Mr. Sewright?</p> <p>15 MR. SEWRIGHT: We can talk off the record</p> <p>16 about it, Mr. Shamburek, I'm not going to get into</p> <p>17 that right now.</p> <p>18 MR. SHAMBUREK: Okay.</p> <p>19 Do you have a transmittal letter, Herb?</p> <p>20 MR. VIERGUTZ: I'm not responding to</p> <p>21 questions at a deposition of a witness.</p> <p>22 MR. SEWRIGHT: Do you want to go off the</p> <p>23 record, Steve?</p> <p>24 MR. SHAMBUREK: Let's go off the record.</p> <p>25 THE WITNESS: Meanwhile, I'm going to</p>	<p style="text-align: right;">Page 46</p> <p>1 MR. VIERGUTZ: No, I'm not. 055 was a</p> <p>2 letter, through 066, that for some reason I omitted</p> <p>3 from the package, and it was either the day after or</p> <p>4 the day after that, I forwarded it to both of you,</p> <p>5 Mr. Sewright and yourself, as well as, I believe,</p> <p>6 Traeger Machetanz at that time.</p> <p>7 And I think, and I'll look, and I could be</p> <p>8 wrong, but I believe my correspondence said just put</p> <p>9 it in there in date order. Which should have been</p> <p>10 in there.</p> <p>11 But, in any event --</p> <p>12 THE WITNESS: I need to know what the</p> <p>13 question was again.</p> <p>14 BY MR. VIERGUTZ:</p> <p>15 Q. My question simply on this letter is, does</p> <p>16 this letter appear to provide USF&G with information</p> <p>17 from Nugget on the claims?</p> <p>18 A. Correct, yes.</p> <p>19 Q. Then Exhibit 3, if we could.</p> <p>20 MR. SHAMBUREK: Herb, again, I have to</p> <p>21 object because I had sent you the e-mail and just</p> <p>22 asked you to pre-mark any exhibits that were going</p> <p>23 to be used and you said there would be none.</p> <p>24 BY MR. VIERGUTZ:</p> <p>25 Q. This is a letter that's within Exhibit 2.</p>
<p style="text-align: right;">Page 45</p> <p>1 review this.</p> <p>2 MR. VIERGUTZ: My only question is, is it a</p> <p>3 letter that appears to respond.</p> <p>4 MR. SEWRIGHT: It's a multi-paged letter,</p> <p>5 Mr. Viergutz.</p> <p>6 Can we go off the record for a moment?</p> <p>7 It's about time to break anyway. It's about 10:30.</p> <p>8 Are we off record? We're not going to go</p> <p>9 off record until Mr. Viergutz says we can.</p> <p>10 COURT REPORTER: I'm waiting until</p> <p>11 everybody agrees to go off record.</p> <p>12 MR. VIERGUTZ: Okay. Fine.</p> <p>13 COURT REPORTER: Off record.</p> <p>14 (Off record.)</p> <p>15 (Exhibit 3 marked.)</p> <p>16 MR. SHAMBUREK: Herb, I'd just like to</p> <p>17 point out that Exhibit 2 was represented to be the</p> <p>18 documents provided to the claimants from USF&G.</p> <p>19 Some of these documents were provided to the</p> <p>20 claimants as a group.</p> <p>21 Now, I don't recall this March 3rd, 1998</p> <p>22 letter; we can deal with that later. But I don't</p> <p>23 think you're representing that it was included</p> <p>24 initially in the packet of material that you</p> <p>25 provided.</p>	<p style="text-align: right;">Page 47</p> <p>1 A. You're referring to the top letter on</p> <p>2 Exhibit 3?</p> <p>3 Q. Yeah. Some of the others may not, but I</p> <p>4 assumed these are all produced.</p> <p>5 If you go to the bottom of page 6.</p> <p>6 A. Of my report?</p> <p>7 Q. Yeah.</p> <p>8 A. Okay.</p> <p>9 Q. That's Exhibit 1.</p> <p>10 A. Yes.</p> <p>11 Q. And there you're saying, about in the third</p> <p>12 or fourth sentence, there does not appear ever to</p> <p>13 have been a discussion of the possible liability for</p> <p>14 the claims of Shoreside Petroleum or Metco, although</p> <p>15 I understand their claims and defenses are similar</p> <p>16 to North Star, blah, blah, blah.</p> <p>17 A. I need to -- you lost me. Where was this?</p> <p>18 Q. Oh, down here. Third or four sentence - --</p> <p>19 A. I see.</p> <p>20 Q. -- from the penultimate paragraph.</p> <p>21 A. Got it.</p> <p>22 Q. And maybe you should read that to the</p> <p>23 bottom.</p> <p>24 A. (Reviews document.)</p> <p>25 Okay.</p>

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<p style="text-align: right;">Page 48</p> <p>1 Q. Then if you'd go to page 4 of Exhibit 3. 2 MR. SEWRIGHT: You mean the fourth page? 3 MR. VIERGUTZ: Yeah. 4 THE WITNESS: That's the letter dated 5 December 3? 6 BY MR. VIERGUTZ: 7 Q. Yeah. That's to Shoreside, correct? 8 A. Yes. 9 Q. From USF&G? 10 A. Yes. 11 Q. And then the next page is a letter to 12 Shoreside dated April 7th? 13 A. Yes. 14 MR. SEWRIGHT: 19 -- 15 THE WITNESS: '98. 16 BY MR. VIERGUTZ: 17 Q. Yeah. One is December 3, '97, one is 18 April 7, '98. Have you ever seen those before? 19 A. I think so. I'm not sure. 20 Q. Are they not documents that discuss the 21 potential liability of Shoreside? 22 A. You just told me that these had been part 23 of the packet, but let me just see. Repeat the 24 question, please. 25 Q. No. I said page 1 was. The others had</p>	<p style="text-align: right;">Page 50</p> <p>1 MR. SHAMBUREK: In his report. 2 MR. VIERGUTZ: Yeah. 3 MR. SHAMBUREK: Not to these boxes of 4 documents that you refer to, or other documents. 5 In your letter you stated here that you 6 wouldn't pay for any of the time to prepare for the 7 deposition. So he couldn't be tasked with taking a 8 look at the entire court file or all the other 9 documents. That was the understanding going into 10 the deposition. 11 THE WITNESS: Well, isn't -- let's go back 12 to my letter at page 6. There does not appear ever 13 to have been a discussion of the possible liability 14 for the claims of Shoreside Petroleum and/or Metco, 15 although I understand their claims, defenses to 16 them, are similar to the ones involving North Star 17 Terminal and Stevedoring. 18 This, what we're talking about here in the 19 exchanges between Mr. Lukjanowicz and Ms. Poling, 20 this is an exchange from Ms. Poling and 21 Mr. Niebrugge, and so I mean, that's consistent. 22 BY MR. VIERGUTZ: 23 Q. Okay. Maybe it's my mistake. What I 24 understood you to be saying there is that neither 25 the Shoreside nor Metco claims were ever addressed</p>
<p style="text-align: right;">Page 49</p> <p>1 been produced. 2 A. Okay. So the question is what? 3 Q. Are not pages -- the two letters we talked 4 about, to Shoreside, pages 4 and 5 of Exhibit 3. 5 A. Yes, the December 3 and the December 7th, 6 yes. 7 Q. Are they not documents that -- 8 A. Or April 7th. 9 Q. You've got a sentence in your report here, 10 and that's what I was trying to get you to read. 11 "There does not appear ever to have been a 12 discussion of the possible liability for the claims 13 of Shoreside Petroleum, Inc. and/or Metco, although 14 I understand that their claims, and defenses to 15 them, are similar to ones involving North Star 16 Terminal and Stevedoring." 17 MR. SHAMBUREK: Herb, I'm going to object 18 to this exhibit. Your letter of March 21, 2006, 19 which we can mark, said: He, Mr. Callow, should 20 know what his report says and there will be no 21 further exhibits, Herb Viergutz. 22 MR. VIERGUTZ: Well, yeah. And I assume 23 he's read, from what he's attached here to his 24 report, the correspondence and things that are being 25 referred to.</p>	<p style="text-align: right;">Page 51</p> <p>1 by USF&G. 2 A. Well, no. Here -- I mean, the April 7th 3 letter they're certainly being addressed. 4 Q. Okay. 5 A. April 7 of '98. 6 Q. Do you recall ever seeing a Shoreside proof 7 of claim in any document you reviewed? 8 A. I don't recall. I don't recall seeing 9 one. 10 Q. Do you recall ever seeing, in what you 11 reviewed, any letter from Shoreside to USF&G 12 transmitting documents to prove up their claim? 13 A. No, I don't. I can't recall that. I -- 14 for the purpose of my report, I assumed that the 15 proof of claim had been made and filed. I figured 16 that this case wouldn't have gotten where it did if 17 there hadn't been an appropriate proof of claim 18 filed. 19 Q. Is the same true for answers regarding 20 Metco? 21 A. Well -- yeah. 22 Q. Did you assume -- my question is, did you 23 assume that they filed a proof of claim and 24 transmitted documents to USF&G? 25 A. Well, when I say "I assumed," as I went</p>

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<p style="text-align: right;">Page 52</p> <p>1 through this, I can't sit here and say that I recall 2 specifically any proof of claim. I guess the best 3 way to say it is, if I went back through the 4 documents to see if they were there, I'm sure I 5 would have noticed if there wasn't a proof of claim. 6 Q. And do you recall seeing -- I think you 7 answered this question, and I don't want to be 8 redundant. But you don't recall seeing any letter 9 from Shoreside or Metco transmitting documents to be 10 reviewed by USF&G? 11 A. As I sit here today, no, and I have to say 12 I didn't -- I didn't review those. 13 Q. Okay. And then the page following the 14 April 7, '98 letter in Exhibit 3 is a letter to 15 Nugget. And that deals with the Shoreside claim, 16 correct? 17 A. Yes, that's correct. 18 Q. Now, do you know whether, at page 2 of 19 Exhibit 3 -- 20 A. Okay. 21 Q. -- the Spencer rock claim referenced in 22 sentence one there, 1,426,707, do you know whether 23 that claim included Metco's claim? 24 A. As I sit here today, I don't recall. 25 Q. Page 7 of your report. The first</p>	<p style="text-align: right;">Page 54</p> <p>1 Nugget's position, there's no question, I believe, 2 that Nugget considered them to be sufficient. 3 The -- I think what you're getting at, and I don't 4 want to put words in your mouth, but I think what 5 you're getting at is, should they have been 6 sufficient for USF&G to simply rely on them. 7 Because my position has always been that 8 USF&G had a duty itself to independently 9 investigate, to not simply just take the word of 10 Nugget. 11 So I don't -- I don't mean to parse your 12 question, I just want to make sure that you and I 13 are on the same page. 14 Q. Just as far as status reports, in cases 15 you've dealt with, are there sufficient status 16 reports? That was my question. 17 A. I would say that that is a typical kind of 18 status report. That's right. 19 Q. Then we go to -- well, let's just ask this 20 general question. In cases that you represent 21 clients, do you always have clients review the 22 pleadings prior to filing? 23 A. If you're talking about pleadings meaning a 24 complaint or an answer, yes. 25 Q. Other pleadings.</p>
<p style="text-align: right;">Page 53</p> <p>1 paragraph, the second sentence -- before we do that. 2 I take it you and I can agree that there's nothing 3 unusual about a surety tendering a claim to the 4 principal -- 5 A. Correct. 6 Q. -- in defense of a claim, correct? 7 A. Uh-huh. 8 Q. Okay. The second and third sentence, do 9 you know whether pleadings that you did not review 10 were transmitted to the surety by Nugget's 11 attorney? 12 A. I don't know that. 13 Q. Do you know -- apparently you've seen a 14 status report, page 055 in Exhibit 2, that you've 15 never seen before today; is that correct? 16 A. That's the 55 through 67? 17 Q. Yeah. 18 A. Yes. 19 Q. Do you opine that the status reports which 20 you did see, which we went through in Exhibit 2 -- 21 A. Uh-huh. 22 Q. -- and the additional one, which you did 23 not see, in your opinion, were they sufficient or 24 should there have been more or less? 25 A. Let me answer the question carefully. From</p>	<p style="text-align: right;">Page 55</p> <p>1 A. You mean like motions or whatever? 2 Q. Yes. 3 A. No, no, not at all. I usually tell them 4 about motions that I file, you know, other than 5 something routine. And I -- but in terms of sitting 6 down and going over them point by point, no, I do 7 not. 8 Q. I'm going to do this just so we don't have 9 any further, hopefully, issue on exhibits. I'm 10 going to mark two more. One is your resume, which 11 was given to me by Mr. Callow. 12 A. No, that would be given to you by 13 Mr. Shamburek, I think. 14 Q. Excuse me, Mr. Shamburek. 15 MR. VIERGUTZ: Can we mark that 4. 16 (Exhibit 4 marked.) 17 BY MR. VIERGUTZ: 18 Q. Is that your resume, sir, Exhibit 4? 19 A. I believe so, yeah. 20 Q. And does that accurately depict your 21 experience and education and such? 22 A. Pretty much, uh-huh. 23 Q. Have you written any articles on surety 24 law? 25 A. I have not.</p>

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<p style="text-align: right;">Page 56</p> <p>1 Q. No publications of any type on surety?</p> <p>2 A. No, sir.</p> <p>3 Q. Okay. And then exhibit -- the last</p> <p>4 exhibit, 5 -- and I do this because of a statement</p> <p>5 that comes up in your report. And we'll get to it.</p> <p>6 But it talks about paragraph, I believe, 38,</p> <p>7 containing bad faith allegations in the complaints</p> <p>8 by the plaintiffs. And I just want to make sure</p> <p>9 we're talking about the same thing.</p> <p>10 So I'd ask these three complaints, North</p> <p>11 Star's amended complaint, Metco's amended complaint,</p> <p>12 and Shoreside's amended complaint be marked together</p> <p>13 as Exhibit 5.</p> <p>14 MR. SHAMBUREK: Herb, if we could just</p> <p>15 note, those are also the docket entries 406, 407,</p> <p>16 and 409?</p> <p>17 MR. VIERGUTZ: Yeah.</p> <p>18 MR. SHAMBUREK: Okay.</p> <p>19 (Exhibit 5 marked.)</p> <p>20 BY MR. VIERGUTZ:</p> <p>21 Q. Now, Exhibit 5, North Star's amended</p> <p>22 complaint.</p> <p>23 A. Yes.</p> <p>24 Q. If you could go to page 24. That's</p> <p>25 paragraph 38 that you're referencing, right?</p>	<p style="text-align: right;">Page 58</p> <p>1 And so a bad faith nonpayment is legitimate</p> <p>2 to say it incorporates failure to investigate.</p> <p>3 Q. Let's go to Shoreside's amended complaint,</p> <p>4 and that's page 19.</p> <p>5 A. All right. I am there.</p> <p>6 Q. At page 38.</p> <p>7 MR. SHAMBUREK: Paragraph 38.</p> <p>8 MR. VIERGUTZ: Paragraph 38, I'm sorry,</p> <p>9 page 19. Thanks.</p> <p>10 BY MR. VIERGUTZ:</p> <p>11 Q. There's a little additional verbiage on</p> <p>12 that paragraph, but there's no specific claim for</p> <p>13 bad faith failure to investigate, would you agree?</p> <p>14 It's again for bad faith nonpayment, nonsettlement,</p> <p>15 and/or refusal to discuss settlement.</p> <p>16 A. Yes, that's correct. The word -- the word</p> <p>17 bad faith failure to investigate, the words do not</p> <p>18 appear there. My answer is the same, though, about</p> <p>19 bad faith nonpayment. I think that, in the liberal</p> <p>20 rules of pleadings, that's...</p> <p>21 MR. VIERGUTZ: Can we go off for a second?</p> <p>22 (Off record)</p> <p>23 BY MR. VIERGUTZ:</p> <p>24 Q. Page 7 of your report, Exhibit 1,</p> <p>25 "Settlement Efforts." Was USF&G obligated to</p>
<p style="text-align: right;">Page 57</p> <p>1 A. Right.</p> <p>2 MR. SEWRIGHT: What page again?</p> <p>3 MR. VIERGUTZ: Page 24 of North Star's</p> <p>4 complaint.</p> <p>5 BY MR. VIERGUTZ:</p> <p>6 Q. Paragraph 38 says: "Upon information and</p> <p>7 belief, and subject to such further evidence as is</p> <p>8 disclosed by discovery, USF&G is also liable to</p> <p>9 North Star, under Alaska law, for the bad faith</p> <p>10 nonpayment, nonsettlement and/or refusal to discuss</p> <p>11 settlement of North Star's claim previously brought</p> <p>12 under the Miller Act herein, of which USF&G was</p> <p>13 notified."</p> <p>14 Where do you see a claim for bad faith</p> <p>15 failure to investigate in that paragraph?</p> <p>16 A. I don't.</p> <p>17 Q. Now, if we could go to Metco's amended --</p> <p>18 A. May I just say this?</p> <p>19 Q. Sure.</p> <p>20 A. When you say bad faith nonpayment, in order</p> <p>21 to make the payment, there has to be an</p> <p>22 investigation. So it's sort of a summary conclusion</p> <p>23 to say -- to say -- when you say there's a bad faith</p> <p>24 nonpayment, you can't make a payment, obviously,</p> <p>25 until you've reasonably investigated.</p>	<p style="text-align: right;">Page 59</p> <p>1 discuss settlement?</p> <p>2 A. Yes.</p> <p>3 Q. Why?</p> <p>4 A. Because they have -- their primary</p> <p>5 obligation is the obligees. And they need -- under</p> <p>6 Alaska law, they need to investigate and promptly</p> <p>7 settle claims. Legitimate claims. And so if they</p> <p>8 fail to promptly and adequately investigate,</p> <p>9 obviously they can't -- they can't settle, but if</p> <p>10 they -- they can't get around the settlement duty by</p> <p>11 failing to properly investigate.</p> <p>12 Q. Could you and I agree that if you have a</p> <p>13 client and I sue you, you don't have any obligation</p> <p>14 to participate in a settlement conference?</p> <p>15 A. If I have a client and you sue my client?</p> <p>16 Q. Uh-huh. You don't have to settle a case</p> <p>17 with me?</p> <p>18 A. If it's not an insurance matter, absolutely</p> <p>19 not.</p> <p>20 Q. But if it's an insurance case and I sue</p> <p>21 you, and your client is a carrier, you have an</p> <p>22 obligation to attend a settlement conference.</p> <p>23 MR. SEWRIGHT: Object to the form.</p> <p>24 THE WITNESS: Well, no. I mean, do I as</p> <p>25 the lawyer for the carrier have an obligation to</p>

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<p style="text-align: right;">Page 60</p> <p>1 attend the settlement conference? I suppose, if 2 there's a settlement conference and it's my client, 3 I have a legal obligation. 4 BY MR. VIERGUTZ: 5 Q. But does your client have the option to 6 say, no, I don't want to settle and I don't want to 7 go to a settlement conference and we're going to 8 trial? 9 A. In the insurance context of what we're -- 10 let's be specific. Are we talking about in the 11 USF&G circumstance? 12 Q. And it's not insurance, it's surety. 13 A. Okay. All right. Surety. Okay. 14 In that circumstance, I believe that a 15 surety is bound to the same rules as an insurance 16 company. I just think it's a subset of insurance 17 companies. And I think that they have a duty to 18 investigate and promptly settle claims under 19 Title 36, and also under -- you know, I've been 20 saying Title 36, and I should be saying -- it's 21 21.36.125, and so anywhere I've been saying Title 36 22 because I -- just my notations I write 36 and then 23 125, but it's really Title 21. 24 MR. SEWRIGHT: So you mean Chapter 36. 25 THE WITNESS: Yes, that's right. Yes,</p>	<p style="text-align: right;">Page 62</p> <p>1 MR. SEWRIGHT: Never communicated to us. 2 BY MR. VIERGUTZ: 3 Q. Do you know who Steven Schoenhaar is in 4 paragraph 2 under "Settlement Efforts" on page 2 of 5 Exhibit 1? 6 A. I just know that he's an employee of 7 USF&G. 8 Q. You don't know what his job description is 9 or where he is? 10 A. Well, the answer to that is, as I sit here 11 no, today, I can't remember. I mean, if he's a -- 12 if he's counsel or an adjuster, I can't remember. 13 Q. And it is not bad faith to refuse to settle 14 if the surety has a good faith basis to believe that 15 the claim is without merit? 16 A. That's correct. 17 And I want to make sure that I'm clear with 18 you on this. By that, I don't want you to take it 19 that I am saying that the -- that USF&G can simply 20 rely on the principal to provide the investigation 21 and the analysis of the claim. USF&G has an 22 independent duty, and only by fulfilling that duty 23 can it end up with a good faith basis for making 24 those decisions. 25 Q. And page 8, under "Later Correspondence</p>
<p style="text-align: right;">Page 61</p> <p>1 that's right. 2 So it's Title 31, Chapter 36.125. And 3 under, I think it's 3 AAC 030 point whatever, I 4 can't remember the 226, that -- there are -- there 5 are duties that insurance companies have to promptly 6 settle claims. 7 BY MR. VIERGUTZ: 8 Q. If they have merit? 9 A. Yes, that's correct. 10 Q. And if your client, the surety, says these 11 claims do not have merit, or they have questionable 12 merit, can they then refuse to settle the claims? 13 A. If they have -- if they have a good faith 14 basis for believing that the claims have no merit, 15 absolutely they can refuse to settle the case. 16 Q. You discuss in your report at page 7 at 17 sentence 3: I understand that prior to the 18 settlement conference, Nugget offered to settle 19 North Star's claim for 20,000, Shoreside claims for 20 5,000, and Metco's claim for 10,000. 21 Were you made aware that Nugget offered to 22 settle the three plaintiffs' claims at the 23 settlement conference for \$120,000? 24 A. I don't recall that specific number, that's 25 correct.</p>	<p style="text-align: right;">Page 63</p> <p>1 Between USF&G and Oles Morrison." 2 A. Yes. 3 Q. The second sentence says, "There is no 4 evidence any copies of those requested documents 5 were ever mailed" -- I think you omitted the "M." 6 A. Yes, I saw that and actually I meant to 7 correct that. 8 Q. Sure. -- "to Mr. Schoenhaar or anyone else 9 at USF&G," right? 10 A. Yes. And I will amend that by saying there 11 is no evidence that I was aware. 12 Q. And those documents are the appeal briefs 13 and such that you're speaking of? 14 A. Yes. I saw no evidence that those were 15 reviewed. 16 Q. And are you relying on what your counsel 17 told you and what your counsel provided to you to 18 come to that conclusion? 19 A. Well, I'm -- what my counsel -- or my 20 counsel. What the people who hired me provided to 21 me, that's what I'm relying on. I don't know that 22 they specifically -- I wouldn't -- if they said 23 there is no evidence, I certainly would have looked 24 to see if there was any evidence. And if they 25 withheld it, I suppose I would -- I took in good</p>

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<p style="text-align: right;">Page 64</p> <p>1 faith what I understood to be that there is no 2 evidence that those documents were ever mailed to 3 Mr. Schoenhaar. 4 Q. Do you feel that you had an independent 5 duty to investigate what Mr. Shamburek told you? 6 A. Well, let me say this. I had -- in my 7 capacity as an expert witness, I relied upon what 8 Mr. Shamburek and Mr. Sewright provided to me as 9 being the information -- I was not an independent 10 investigator. If I -- if I had been hired by the 11 court or if I had a duty to any of the other 12 parties, I would not have relied simply on what they 13 provided. 14 But in this case I was retained to provide 15 my opinion and was provided with documents, and I 16 relied upon the documents that they provided me. 17 Q. If you'd go to page 8 of Exhibit 1. The 18 section above claimant's challenges to USF&G's 19 actions and inactions? 20 A. The part that starts "Janice S. Smith"; 21 yes. That paragraph? 22 Q. Yeah, that paragraph, but the second to the 23 last, the penultimate sentence of that paragraph. 24 A. Ms. Williams' letter? 25 Q. Yeah. Yeah. There in the last sentence,</p>	<p style="text-align: right;">Page 66</p> <p>1 question. I think that misstates the testimony, 2 or what -- 3 THE WITNESS: Well, let me just say this -- 4 MR. SEWRIGHT: -- you've presented, 5 Mr. Viergutz. 6 THE WITNESS: -- the one that I -- the one 7 that I -- I'm sorry. I know better. 8 MR. VIERGUTZ: He can say object to form, 9 period -- 10 MR. SEWRIGHT: Object to form. 11 MR. VIERGUTZ: -- the rest of it was 12 irrelevant anyway. 13 MR. SEWRIGHT: It wasn't irrelevant, but -- 14 MR. VIERGUTZ: Go ahead. 15 MR. SEWRIGHT: Anyway, go ahead. 16 THE WITNESS: Gentlemen, I'm sorry that I 17 interrupted you. I know better as a lawyer that I 18 should let you guys talk. 19 But let me just say this. What I recall is 20 that -- I recall that March letter that was pages 55 21 through 67, that's the one that I recall is of 22 substance. 23 I don't -- the others -- and you say, well, 24 they're -- were there any -- were the other letters 25 of any substance. That's a question of were they</p>
<p style="text-align: right;">Page 65</p> <p>1 "This appears to be the only discussion of the case 2 of any substance in writing since the first 3 complaint was filed in January '98 by North Star." 4 Can we agree now that that is not correct 5 based on the status reports we've gone through and 6 No. 55 through 66 that you've seen? 7 A. Let me take a moment and read the whole 8 paragraph to make sure I put this in context. 9 Q. Sure. 10 A. (Reviews document.) 11 MR. SHAMBUREK: And, Herb, I just observe 12 the continuing objection -- 13 MR. VIERGUTZ: Sure. 14 MR. SHAMBUREK: -- to the letter included 15 in the Exhibit 2, that number 55 to -- 62? 16 MR. VIERGUTZ: Uh-huh. 66. 17 THE WITNESS: Well, when we're talking 18 about the only discussion of the case of any 19 substance in writing, there was this -- there was 20 this March letter from Oles Morrison to USF&G, 21 correct. 22 BY MR. VIERGUTZ: 23 Q. And there were other status reports; isn't 24 that correct? 25 MR. SEWRIGHT: Object to the form of the</p>	<p style="text-align: right;">Page 67</p> <p>1 really of substance in terms of what we're talking 2 about in terms of what USF&G needed to do. The 3 answer is no, but certainly that March '98 letter 4 was of substance, that's correct. 5 BY MR. VIERGUTZ: 6 Q. Then on page 8 under the "Claimants' 7 Challenges To USF&G's Actions And Inactions," and 8 you quote for the next -- through page 11, to the 9 conclusion. 10 A. Yes. 11 Q. You're just quoting the third supplemental 12 discovery response of Shoreside? 13 A. Yes, that's right. 14 Q. And Metco's supplemental discovery 15 response? 16 A. Yes. 17 Q. Are you relying on those as true and 18 accurate in the construction of your report? 19 A. Yes. I'm relying on those as providing 20 information that should have -- that should have 21 been known by USF&G, that's correct. 22 Q. Let's go through it, then. On page 8, the 23 first paragraph of the quote, your last sentence. 24 And you may need to read that first full paragraph 25 of the quote. The last sentence says, "The</p>

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<p style="text-align: right;">Page 68</p> <p>1 obligation to pay did not depend on the narrower 2 definitions of suppliers and subcontractors in the 3 Miller Act." And I want to know, why not? 4 A. Well, there is a -- as I recall, there 5 is a -- there's a CFR on that, as I recall. Or was 6 it the -- I -- I can't -- I can't tell you right 7 now, but I remember that there is -- there is a 8 legal reason for that statement. 9 You know, let me just say this. Where I -- 10 where -- I mean, I read that and I didn't flinch 11 because I -- as you know, there are the letters from 12 the Corps saying: We remind you that under contract 13 clause I.55, payments under fixed-price, you're not 14 to request -- let me see here. 15 "This request for progress payment does not 16 include any amounts which the prime contractor 17 intends to withhold or retain from a subcontractor 18 or supplier." 19 I don't know. As I sit here today, I can't 20 tell you specifically. 21 Q. Okay. That's fair. 22 The final paragraph of page 8, USF&G knew 23 or should have known that Nugget was secretly 24 structuring its transactions so that Nugget could 25 deceive the Corps of Engineers and the three</p>	<p style="text-align: right;">Page 70</p> <p>1 than simply paying the claim of the obligee in the 2 event the principal does not pay it, correct? 3 A. There is a duty to the obligee -- repeat 4 that again, please. 5 MR. VIERGUTZ: Would you read it back. 6 (Question read back.) 7 MR. SHAMBUREK: I just object to the 8 question, because it's been asked and answered. 9 MR. SEWRIGHT: Also the form, beyond asked 10 and answered. 11 THE WITNESS: Let me say that there's a 12 duty beyond -- that's the phrase you used. There is 13 a duty to pay legitimate claims and that is the 14 ultimate duty, so when you say there's a duty 15 beyond, I want to say this, it's really not be 16 beyond, it's a precursor duty to properly 17 investigate, but I think we're understanding each 18 other. 19 BY MR. VIERGUTZ: 20 Q. Isn't it correct that the surety has no 21 duty whatsoever to the obligee if the principal pays 22 the claim? 23 MR. SHAMBUREK: Object; asked and answered. 24 MR. SEWRIGHT: Object to the form 25 otherwise, too.</p>
<p style="text-align: right;">Page 69</p> <p>1 claimants regarding the actual contractual 2 relationship, yadda, yadda, yadda. 3 How should USF&G have known that? 4 A. Well, by doing an independent 5 investigation. 6 Q. If it was a secret, how would they have 7 known it? 8 A. Well, if it was a secret it was -- it was 9 Nugget that was trying to set this up and keep it a 10 secret. USF&G would have known by talking to the 11 obligees themselves and finding out the nature of 12 the transactions. 13 Q. And would they have an affirmative duty to 14 believe, over the principal, the positions of the 15 obligees? 16 A. Well, that -- my position has been that 17 legally they owe a duty to the obligees that I 18 consider to be paramount to their duty to the 19 principal. 20 And they are -- that is -- but that doesn't 21 mean that they should necessarily believe. They 22 need to do an independent investigation and make a 23 determination. 24 Q. And that analysis is based upon your 25 position that there is a duty to the obligee more</p>	<p style="text-align: right;">Page 71</p> <p>1 THE WITNESS: Okay. If -- if the principal 2 pays the claim, the surety has no further duty to 3 the obligee, that's correct. 4 BY MR. VIERGUTZ: 5 Q. So your entire analysis on the duties of 6 the obligee -- you and I aren't communicating. I'm 7 saying -- 8 A. The duties of the obligee? 9 Q. I'm saying to you -- excuse me, the duty of 10 the surety. 11 A. Okay. 12 Q. The only duty of the surety is to pay a 13 claim to an obligee in the event it is not paid by 14 the principal. And you disagree with that 15 proposition, do you not? 16 A. Well -- 17 MR. SHAMBUREK: Asked and answered; but go 18 ahead. 19 THE WITNESS: The answer is yes; but 20 there's -- there's a question of timing here. And 21 there is -- I think it's 31 CFR, it's like 223.18, 22 that provides that the surety has the duty to timely 23 pay if -- pay the obligee, if the -- if the 24 principal does not pay. 25 So where a principal refuses to timely pay</p>

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<p style="text-align: right;">Page 72</p> <p>1 and without just cause, the surety can't just wait 2 for as long as the principal wants and drag out the 3 payment of the claim. 4 So you can't just say, well, the 5 principal -- we're just working through this, the 6 principal is fighting this claim and working this 7 out. The surety would have a duty to independently 8 investigate and determine if in fact the claim to 9 the surety's mind is a valid claim, the surety pays 10 the claimant, and then seeks indemnity if the 11 surety -- this gets back to the beginning of my 12 testimony. If the surety overpays, pays a claim it 13 shouldn't have, the surety is out the money. 14 BY MR. VIERGUTZ: 15 Q. Okay. And in this case, are you saying 16 that the claims should have been paid? 17 A. Yes. 18 Q. Why? 19 A. I think that -- well -- 20 MR. SHAMBUREK: If I could just object to 21 asked and answered. 22 THE WITNESS: Let me say this. I think 23 that these claims -- well... These claims weren't 24 properly investigated by USF&G. Had they been 25 properly investigated -- it's difficult to say what</p>	<p style="text-align: right;">Page 74</p> <p>1 Q. Now, paragraph 2 of page 9. "USF&G knew or 2 should have known that Oles Morrison may have been 3 involved in structuring the transactions to create a 4 straw man relationship with Spencer Rock and a 5 hollow shell constituting subterfuge under the 6 Miller Act in order to seek to excuse Nugget's 7 willful nonpayment to the three claimants." 8 How should USF&G have known that Oles 9 Morrison may have been involved in structuring the 10 transactions to create -- 11 A. Well, simply by -- by just doing an 12 investigation. Remember, this is -- these are 13 allegations in the complaint, they're not -- they're 14 not what I wrote. But had USF&G properly 15 investigated and determined what the -- what the 16 nature of the transactions were, apparently this -- 17 the allegation here is that they certainly would 18 have -- USF&G would have known that Oles Morrison 19 was protecting its client, Nugget; and, therefore, 20 would have been alerted to the need to -- USF&G 21 would have been alerted to the need to undertake its 22 own investigation. 23 Q. But that paragraph assumes that that 24 happened; isn't that correct? 25 A. It assumes -- yes, that's correct. Yes,</p>
<p style="text-align: right;">Page 73</p> <p>1 would have happened if USF&G had properly 2 investigated. 3 But the fact that USF&G did not properly 4 investigate leads to sort of a begging of the 5 question of whether it had done so, those claims 6 would have been properly paid. 7 BY MR. VIERGUTZ: 8 Q. Why, because the court hasn't even 9 determined that they're valid claims yet. 10 MR. SHAMBUREK: Lacks foundation. 11 THE WITNESS: Well, let me say this. If 12 the defenses are -- isn't this -- isn't it true that 13 this case has gone up to the Ninth Circuit twice? I 14 think it has. And the Ninth Circuit has reversed, 15 but my understanding is that there has -- that the 16 claims are valid, there's just a question of value; 17 is that correct? 18 BY MR. VIERGUTZ: 19 Q. And if that's not correct, would that 20 change your analysis? 21 A. If the claims are not valid and it's 22 determined that they're not valid, then in that case 23 there is -- there is -- there would be no duty on 24 the part of the surety to pay an invalid claim, 25 that's correct.</p>	<p style="text-align: right;">Page 75</p> <p>1 that's correct. 2 Q. If it didn't happen, then there's no basis 3 for that in that paragraph, that allegation, 4 correct? 5 A. Well, if the facts don't support -- it's an 6 allegation, if the facts don't support it, that's 7 correct. 8 Q. Now, the final paragraph at page 9. "The 9 decision by the District Judge in this case finding 10 that Spencer Rock Products was a subcontractor to 11 Nugget under the Miller Act was and is a correct 12 interpretation of the relevant decisions of the 13 United States Supreme Court." 14 However, Mr. Callow, that's not what the 15 opinion of the Ninth Circuit is, is it? 16 A. That's correct. 17 Q. And we've gone through this again, so it's 18 asked and answered, but the Ninth Circuit is the law 19 of the land over the -- 20 A. That's correct. Over the district court. 21 Q. Thank you. Page 10. 22 A. Yes. 23 Q. The first paragraph under Metco's 24 supplemental language. It says, "USF&G's records 25 indicate that it never did anything with the</p>

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<p style="text-align: right;">Page 76</p> <p>1 information it had regarding the three claims. If 2 USF&G did anything, there is no record of what it 3 did." 4 Isn't that disputed by Exhibit 3, the 5 letters, pages 4, 5, 6? 6 A. Exhibit 3, pages 4, 5, 6, we're talking 7 about -- 8 Q. Any of those claims. LaPore's claims, 9 Chugach Rock's claim, North Star's claim, 10 Shoreside's claim. Aren't they writing the 11 claimants asking for additional information and 12 trying to get more from them to be knowledgeable? 13 A. Well, let me say this. The allegations 14 said they never did anything with the information it 15 had regarding the three claims, that's a little bit 16 different than -- but anyway, I understand what 17 you're saying. 18 Certainly those letters refer to the 19 claims, but I think the allegation said they never 20 did anything with the information that they 21 obtained. 22 Q. The information that had been provided by 23 the claimants resulted in USF&G denying the claims; 24 isn't that correct? 25 MR. SEWRIGHT: Object to the form of the</p>	<p style="text-align: right;">Page 78</p> <p>1 from the obligees, that's correct. 2 BY MR. VIERGUTZ: 3 Q. And then the next paragraph, or the third 4 one on page 10 under that heading, says, "There were 5 a number of settlement opportunities in this case. 6 The three claimants each expended resources 7 preparing settlement offers in earnest throughout 8 this litigation which appear never to have been 9 considered in good faith by the defendants." 10 What evidence are you aware of that that 11 statement is accurate? 12 A. What evidence am I aware of? 13 Q. Uh-huh. Yes. 14 A. I'm aware of representations made to me by 15 Mr. Shamburek and Mr. Sewright. I don't recall 16 actually preparing the settlement -- or reviewing 17 any settlement offers in this case. 18 Q. Would you agree it's standard practice in 19 the industry for a surety to require general 20 agreement of indemnity to be signed by the 21 indemnitors? 22 A. I can't speak to whether it is standard 23 practice. It's not uncommon. That's my 24 understanding. 25 Q. Page 11 under "Conclusion." I don't</p>
<p style="text-align: right;">Page 77</p> <p>1 question. 2 THE WITNESS: Well, the answer is, yes, 3 USF&G denied the claims. 4 BY MR. VIERGUTZ: 5 Q. And in those letters requesting further 6 information from the claimants, was it not the 7 obligation of the claimants then to provide 8 additional information? 9 MR. SEWRIGHT: Object to the form of the 10 question. And also out of context, Mr. Viergutz, 11 from some -- 12 MR. VIERGUTZ: You object to the form, 13 period. 14 MR. SEWRIGHT: -- of these letters there 15 was a lawsuit filed. 16 Object to the form. 17 MR. VIERGUTZ: Just object to the form. 18 The running objection is unnecessary. 19 THE WITNESS: Let's -- may I have the 20 question again, please. 21 (Question read back.) 22 MR. SEWRIGHT: And the objection is to the 23 form. 24 THE WITNESS: When -- an insurer or a 25 surety has a right to seek reasonable information</p>	<p style="text-align: right;">Page 79</p> <p>1 understand the third sentence where it says, 2 "Neither Nugget nor USF&G contested those 3 assertions." I don't understand what the Ninth 4 Circuit appeal was all about if those assertions 5 weren't contested. Can you tell me what you're 6 speaking to? 7 A. Just give me a moment here, I want to just 8 put this... 9 (Reviews document.) 10 MR. VIERGUTZ: Can we go off for just a 11 second? 12 (Off record) 13 THE WITNESS: Let's go back on record. 14 Your question is, what was the Ninth 15 Circuit opinion all about? 16 BY MR. VIERGUTZ: 17 Q. Yeah, what is that appeal all about? 18 A. Well, are you talking about the one -- the 19 Ninth Circuit appeal referred to where the panel 20 came out with a decision in March of 2005? 21 Q. The most recent one, yeah. 22 MR. SEWRIGHT: I'm going to object to the 23 form of the question, to that line of questioning. 24 THE WITNESS: Well, my understanding is 25 that the Ninth Circuit opinion, the one from</p>

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<p style="text-align: right;">Page 80</p> <p>1 March 3rd of 2005, merely said that there was -- 2 there was sufficient evidence to create a material 3 issue of fact around subterfuge and collusion; 4 that's different than saying that Nugget contested 5 the assertions that services had been performed or 6 services hasn't been provided. 7 BY MR. VIERGUTZ: 8 Q. But the services were provided or goods 9 were provided for the use and benefit of the bonded 10 Homer project, correct? And that's been contested; 11 isn't that correct? 12 MR. SEWRIGHT: Object to the form. 13 THE WITNESS: That the goods and services 14 have been provided, yes, that is -- that has been 15 contested, that's correct. 16 BY MR. VIERGUTZ: 17 Q. And then the next paragraph, the final 18 sentence it says, "USF&G knew or should have known 19 that the support agreement and subsequent activities 20 changed their legal relationship of the parties." 21 How were the legal relationships changed? 22 A. Well -- 23 MR. SEWRIGHT: I'm going to object to the 24 form. 25 ///</p>	<p style="text-align: right;">Page 82</p> <p>1 Isn't that true of the plaintiffs 2 equally? 3 A. It -- well, it is -- it is true in 4 litigation in general, both plaintiffs and 5 defendants, that litigation for relatively small 6 amounts is uneconomical, that's correct. 7 And with the costs of litigation being what 8 they are today, you know, \$100,000 is -- well, from 9 my point of view, I won't even take a case that's 10 less than \$100,000 at issue, just because of the 11 cost of litigation. 12 And in my experience insurers know that it 13 is economically -- it creates a great economic 14 hardship to force -- force people to litigate. 15 Q. On page 12, the second line, you talk about 16 economic coercion. Is it your position USF&G is 17 guilty of that despite they weren't paying any 18 attorney fees in this litigation? 19 A. Well, it's my position that it is 20 economically coercive for USF&G not to have 21 investigated and paid a valid claim for these 22 claimants. That itself is economic coercion. It is 23 the whole purpose of the Miller Act to make sure 24 that claimants get paid and in a timely fashion for 25 valid claims.</p>
<p style="text-align: right;">Page 81</p> <p>1 BY MR. VIERGUTZ: 2 Q. Are you speaking there to the fact that by 3 the position of Nugget they would not then have been 4 covered under the bond? 5 A. Well, that's the Nugget position, that's 6 correct. Yes. 7 Q. Okay. And that changed the legal 8 relationship? 9 A. Uh-huh. 10 Q. Okay. Do you know what you're talking 11 about when you say "subsequent activities"; do you 12 recall? 13 A. Well, that support agreement, if I recall, 14 was in -- I think it's in '97. And I can't remember 15 when the support agreement was right now. But there 16 were, particularly with Spencer Rock, and Nugget's 17 relationship was basically taking over Spencer Rock, 18 I think that was -- I think that's -- as I recall, 19 that's what I was referring to. 20 Q. The last paragraph, it says, "Litigating a 21 case that involves less than \$100,000 is often 22 uneconomical for all involved. A party can defend 23 against any claim, but committing a disproportionate 24 sum to challenging well-founded claims is 25 problematic and usually economically irrational."</p>	<p style="text-align: right;">Page 83</p> <p>1 And so to the extent that USF&G failed to 2 fulfill its obligations and forced these obligees 3 not only to litigate, but to forgo the income, that 4 is economically coercive, absolutely. 5 And I think if you look at the applicable 6 statutes and the Miller Act itself and that CFR that 7 I was telling you about, that is precisely the 8 purpose for why there are these duties. 9 And all those -- all those State statutes 10 and the applicable CFRs are incorporated by 11 reference in the -- in the surety contract itself. 12 Q. And that's true despite the fact that the 13 claimants twice prevailed at the Ninth Circuit? 14 MR. SEWRIGHT: Object to the form of the 15 question. 16 THE WITNESS: Well, the answer is, correct, 17 it is true in spite of the fact -- what I just said 18 is true in spite of the fact that the claimants 19 prevailed at the Ninth Circuit. 20 MR. SHAMBUREK: Herb, this is the amended 21 complaint that supplants the other one? 22 THE WITNESS: Am I going back to Exhibit 5? 23 MR. VIERGUTZ: We can handle that quick if 24 you want to. 25 THE WITNESS: Are we going to have this</p>

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<p style="text-align: right;">Page 84</p> <p>1 marked?</p> <p>2 MR. SEWRIGHT: Are we off the record?</p> <p>3 MR. VIERGUTZ: Yeah, go off the record.</p> <p>4 (Off record)</p> <p>5 BY MR. VIERGUTZ:</p> <p>6 Q. The last complaint, amended complaint in</p> <p>7 Exhibit 5, is the Metco amended complaint --</p> <p>8 A. Yes.</p> <p>9 Q. -- dated August 31, '05. And paragraph 38</p> <p>10 at that --</p> <p>11 A. I'm there.</p> <p>12 Q. -- amended complaint --</p> <p>13 A. Page 18.</p> <p>14 Q. Yeah. That's the same identical language</p> <p>15 as the Shoreside amended complaint at paragraph 38,</p> <p>16 correct?</p> <p>17 A. That's correct.</p> <p>18 Q. Now, back to Exhibit 1.</p> <p>19 A. Yes.</p> <p>20 Q. In that first paragraph of page 12.</p> <p>21 A. Yes.</p> <p>22 Q. The second sentence there, it says, "The</p> <p>23 litigation tactics of Nugget and USF&G have</p> <p>24 reportedly escalated the costs unreasonably."</p> <p>25 A. Yes.</p>	<p style="text-align: right;">Page 86</p> <p>1 reference to the notice in it.</p> <p>2 Well, I don't know right now, looking back</p> <p>3 through the report, I don't want to waste a lot of</p> <p>4 time, but that's my understanding, is that this</p> <p>5 is -- they were litigating whether the notice of the</p> <p>6 claim was adequate, and...</p> <p>7 Q. Okay.</p> <p>8 A. Yeah.</p> <p>9 Q. Now, the paragraph right under that --</p> <p>10 A. Yes.</p> <p>11 Q. -- one sentence, it says, "A strategy of</p> <p>12 trying to economically overwhelm an intended</p> <p>13 contract beneficiary that asserts a valid claim by</p> <p>14 trying to force that party into submission by</p> <p>15 litigating frivolous issues and defenses that cause</p> <p>16 the claimants to incur inordinate legal fees is bad</p> <p>17 faith."</p> <p>18 A. Yes.</p> <p>19 Q. That presupposes that the contention has</p> <p>20 merit, correct?</p> <p>21 A. Yes. That's why it says "asserts a valid</p> <p>22 claim," yes.</p> <p>23 Q. And that's a question of fact, isn't it?</p> <p>24 A. It is a question of fact.</p> <p>25 Q. You have not served as an expert witness</p>
<p style="text-align: right;">Page 85</p> <p>1 Q. Is that based on representations made to</p> <p>2 you by Mr. Shamburek and Sewright?</p> <p>3 A. Yes.</p> <p>4 Q. Then the last sentence, "Nugget and USF&G</p> <p>5 have apparently committed enormous sums to litigate</p> <p>6 this case which are far out of line with the total</p> <p>7 amount in controversy." And that would be equally</p> <p>8 true for the claimants, correct?</p> <p>9 A. Yes, that's correct.</p> <p>10 Q. And then the next paragraph -- my question</p> <p>11 simply is the first sentence, it says, "...whether</p> <p>12 the notice discussed above was accurate." I'm</p> <p>13 wondering what notice are we talking about? I</p> <p>14 couldn't follow that.</p> <p>15 A. Where are you now?</p> <p>16 Q. The second paragraph where --</p> <p>17 A. Yes.</p> <p>18 Q. -- it starts "Shoreside contends."</p> <p>19 A. Yes.</p> <p>20 Q. And toward the end of that sentence it</p> <p>21 says, "...and whether the notice discussed above was</p> <p>22 adequate."</p> <p>23 A. (Reviews document.)</p> <p>24 I wonder if this is an editing thing. Let</p> <p>25 me just take a moment and find where there's a</p>	<p style="text-align: right;">Page 87</p> <p>1 regarding bad faith practices of a surety or</p> <p>2 insured, correct?</p> <p>3 A. Correct.</p> <p>4 Q. Have you ever served as an expert witness</p> <p>5 in any case?</p> <p>6 A. I'm trying to think.</p> <p>7 I've testified a number of times; I don't</p> <p>8 know whether I have been asked to testify as an</p> <p>9 expert. I was -- I testified in the Weiford case.</p> <p>10 I don't -- I don't believe that I've been asked to</p> <p>11 testify as an expert previously.</p> <p>12 Q. Do you know Mr. Shamburek socially?</p> <p>13 A. Yes, somewhat, uh-huh.</p> <p>14 Q. How long have you known him?</p> <p>15 A. Oh, I would say probably 20 years. I got</p> <p>16 to know him when he was practicing with Randy</p> <p>17 Farleigh, when it was Farleigh & Shamburek. And</p> <p>18 actually, he was on the other side of a case that I</p> <p>19 had briefly. But I had met him professionally from</p> <p>20 Mr. Shamburek -- I mean, Mr. Farleigh.</p> <p>21 We had this case together, or where he was</p> <p>22 on the other side, and he now has -- maintains an</p> <p>23 office down the hall, office sharing, from me. So I</p> <p>24 see him fairly regularly when he stops into that</p> <p>25 office.</p>

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1 MR. VIERGUTZ: I appreciate you being here
2 today. Thank you.
3 THE WITNESS: Sure.
4 (Proceedings concluded at 11:53 a.m.)
5 (Signature reserved.)
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1 REPORTER'S CERTIFICATE

2

3

4 I, KATHERINE L. NOVAK, RPR, Registered
5 Professional Reporter, hereby certify:

6 That I am a Court Reporter and Notary
7 Public for the State of Alaska; that the deponent
8 was duly sworn; that the foregoing proceedings were
9 taken by me in Stenotype Shorthand and thereafter
10 transcribed by me; that the transcript constitutes a
11 full, true and correct record of said proceedings
12 taken on the date and time indicated therein; and
13 that signature is reserved.

14 Further, that I am a disinterested
15 person to said action.

16 IN WITNESS WHEREOF, I have hereunto
17 subscribed my hand and affixed my official seal this
18 10th day of April 2006.

19

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22

Katherine L. Novak, RPR,
and Notary Public for the
State of Alaska.

23

24

My Commission Expires 6-10-09

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